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### Summary

Argentina is not going to pay its debts to private creditors or multilateral institutions. President Nestor Kirchner's debt-restructuring strategy consists of repudiating practically all of an estimated \$88 billion to \$100 billion in government debts in default since December 2001. However, creditors and investors are having trouble coming to grips with this reality.

### Analysis

Argentina's strategy for restructuring between \$88 billion and \$100 billion in foreign debt on which it defaulted two years ago is to avoid repaying more than 90 percent of it. As part of that strategy, President Nestor Kirchner also wants the International Monetary Fund and all of the G7 governments to commit to making fresh loans to Argentina to help with future economic development.

So far the IMF and its largest financial contributor -- the U.S. government -- have been dancing to Kirchner's tune. This might change if the Bush administration decides in coming weeks to exert its influence on the IMF's board of directors to pressure Kirchner instead of coddling him on the issue. Many of the IMF's bureaucrats and its member governments likely would support bringing more pressure to bear on Argentina by suspending financial aid until Kirchner starts negotiating seriously with the country's creditors. However, the Bush administration appears to be of two minds about Argentina.

In January 2003 the U.S. administration opposed more IMF bailouts for Buenos Aires. In September of that same year, the U.S. administration reversed course and twisted arms within the IMF to roll over up to \$21 billion-worth of debts Argentina owed the fund and other multilateral financial institutions, a move in violation of the fund's bylaws and lending rules. The deal signed five months ago called for Argentina to quickly start debt restructuring negotiations with its creditors. However, Kirchner didn't advance the debt negotiations at all, although he reportedly has agreed to forgive billions of dollars that Cuba owes Argentina.

The Kirchner government arguably has violated the September 2003 agreement with the IMF, which called for Argentina to undertake "good faith" negotiations with its foreign creditors. Nevertheless, a majority of the IMF board, led by the United States and France, recently approved disbursing another \$358 million to Buenos Aires so it could remain current on its debt payments to the IMF and other multilateral entities.

The Bush administration's apparent confusion over Argentina might have several explanations. For example, it there are far more pressing issues on the White House radar such as Iraq, the war on terrorism, the 2004 presidential re-election campaign and colonizing the moon. It's also possible that there are internal disagreements between career State

Department officials and political appointees over how to manage relations with Kirchner.

Sources in Washington told Stratfor recently that some U.S. officials would like to take a harder line with Kirchner over issues like debt restructuring and Cuba. However, others counsel a softer approach in order to avoid creating unnecessary tensions at a time when the Bush administration already confronts difficult relations with the presidents of Venezuela and Brazil and social turmoil across much of the Andean region.

Stratfor's view is that it doesn't matter whether the Bush administration twists arms or tries to reason with Buenos Aires. The Kirchner government has defined its debt-restructuring strategy and it's going to stick with that strategy. There is a little room to tweak Kirchner's debt-restructuring proposal, but the bottom line is that foreign creditors will lose practically all of the money they invested in government bonds.

Kirchner's approach to "negotiating" with the IMF has been as hardnosed as his approach to Argentina's private creditors. Kirchner's basic argument is that Argentina does not have the foreign exchange reserves or economic stability to pay its debts. If the fund refuses to roll over these debts as they come due, Argentina won't pay them anyway. Kirchner says he won't sacrifice Argentina's social welfare (and by extension the stability of his government) by cutting back on social programs in order to pay more debt. He adds that in order to pay more debt, his government would have to tax Argentines at higher rates.

The IMF board has responded to Kirchner's intransigence by breaking its own lending rules to accommodate his demands, mainly because it doesn't want to be confronted with the institutional and political consequences of an Argentine default to its multilateral creditors. If Argentina walks away from its private and multilateral debts successfully -- meaning that it doesn't collapse economically when it is shut out of international financial markets completely after repudiating its debt -- then other countries might soon take the same path. This could finish what little institutional and geopolitical relevance the IMF has left.

Buenos Aires has dealt just as harshly with an estimated 700,000 holders of government bonds in default. Estimates on the total size of that debt range from \$88 billion to slightly more than \$100 billion, according to different official and private calculations. Whatever the true total, Kirchner has insisted there will be no change in Argentina's proposal that 75 percent to 90 percent of the defaulted debt be written off.

Argentina's creditors have rejected these terms. Kirchner's response in essence has been to tell the creditors they can take it or leave it. His position is that this is a one-time-only offer, and creditors won't collect anything if they decline -- not even the eight cents on a dollar they would receive in about 20 years by agreeing to his restructuring proposal.

Some creditors have already taken Argentina to court in New York, obtaining a judgment that allowed them to start embargoing Argentine assets as of Jan. 30, 2004. However, Kirchner's government is unimpressed. Senior officials told Buenos Aires daily La Nacion on Feb. 1 that Argentina's government doesn't have any assets overseas that could be seized, and its diplomatic representations are immune from such seizures under international law.

After giving Buenos Aires another \$358 million recently, IMF Executive Director Horst Kohler indicated that this was the last time the fund would roll over for Kirchner. The top IMF official also said the "most critical"

issue confronting Argentina between now and March 2004 is to advance on restructuring the defaulted debt. In March the IMF board again will review Argentina's compliance with the September 2003 agreement, just as Buenos Aires is due to repay \$3.3 billion it owes the fund and other multilateral entities.

If Kohler was hinting that crunch time between Argentina and the IMF could come in March, Buenos Aires wasn't listening. After the IMF approved the \$358 million disbursement to Argentina, Economy Minister Roberto Lavagna reaffirmed that the government wouldn't modify its debt-restructuring proposal.

The conventional wisdom is that Kirchner is taking Argentina down the path toward economic ruin if he repudiates its debts to private and multilateral lenders. Countries that have taken this route before, like Zimbabwe, are international pariahs. Access to new foreign loans is cut off, multilateral lending (mainly for social programs) is shut down and foreign investment dries up. Kirchner appears to be gambling that the conventional wisdom is mistaken.

Kirchner does appear to have several things in his favor. His popularity with voters remains high, the economy grew more than 7 percent in 2003 and might do even better in 2004, exports are up sharply thanks to booming demand in China for Argentina's agricultural commodities and the country had a trade surplus of nearly \$16 billion in 2003. Kirchner also has hitched his geopolitical wagon to Brazilian President Luis Inacio "Lula" da Silva to such an extent that both countries are "sharing" the temporary U.N. Security Council seat Brazil will hold in 2004-2005 and Argentina will take over in 2006 and 2007.

Apparently Kirchner hopes to offset any loss Argentina might suffer in traditional financial markets from repudiating its debts by developing new geopolitical and economic links with emerging regional powers like China and India.

The downside to Kirchner's strategy is that his assumptions about its chances of success might be completely wrong. Bankers and investors who get fleeced by Argentina's government won't make the same mistake twice. Argentina might find itself forced to conduct all international trade in hard currency rather than commercial credit, just like Cuba. Despite his current domestic popularity, many voters with hard currency savings deposited outside Argentina or stashed in cash at home likely will be reluctant to put their capital into Argentina's economy if they think their country has become isolated. Their primary concern is to preserve the real liquid value of their capital.

Kirchner could calculate that he has nothing to lose by pushing his tough debt-restructuring proposal to its ultimate consequences. If he succeeds and Argentina's economy achieves sustained robust growth, he would be a hero at home regardless of what foreign bankers think. However, if Kirchner fails and Argentina's economy stumbles again, the price of failure could be his job.